2:00 – 3:00 p.m. ET

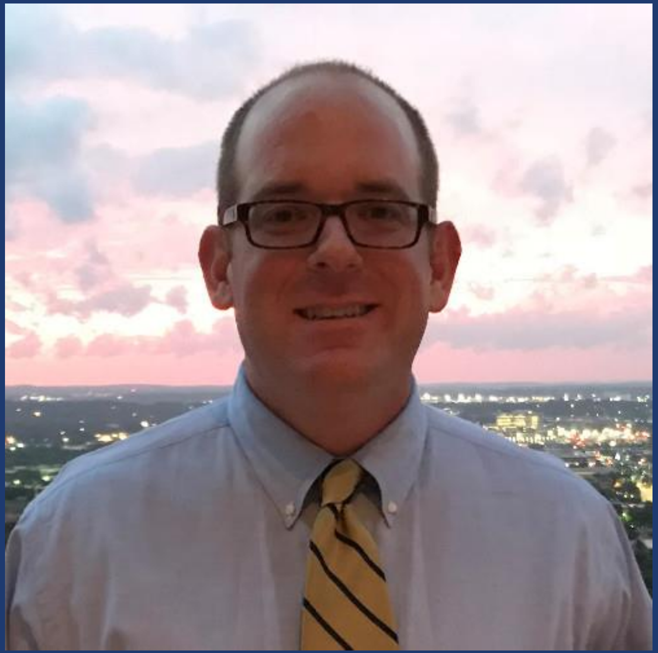
Top 5 Audit Risks for ASC 842 Lease Accounting Compliance

Tips for reviewing policies, procedures and system use - with Matt Waters, CPA

CoStar REAL ESTATE MANAGER™

Presented By

Matt Waters is the former Lease Accounting Manager with Home Depot (6 years) and American Tower (100,000+ leases!). He is CoStar's subject matter expert with more than 15 years of management experience in accounting and finance.



Matt Waters, MBA, CPA

Lease Accounting Specialist at CoStar

Top 5 Audit Risks for Lease Accounting Compliance

As corporate accounting teams rush to implement policies and processes for ASC 842 and IFRS 16 lease accounting compliance, audit firms are also diligently preparing for the changes to audit procedures as a result of the new guidance. Here are five major areas that companies must focus on today, because auditors will focus on verifying these things beginning in 2019.

First Polling Question:

Which of the follow best describes your company's current status for gathering all the lease data points needed for ASC 842 accounting calculations?

1. We have everything needed in a nice spreadsheet format.
2. We think we have all the data, but could be missing some.
3. We've only started to realize what a big data collection job is ahead.
4. We're here to learn what kinds of data points we need to find.

1. A Complete Collection of Lease Obligations

Leases can originate from a decentralized, diverse group of departments across the company. Various departments utilize leases with very little impact or involvement from other groups, and costs are often simply categorized as an expense within the department's budget. As a result, control of leases may be dispersed throughout the company and visibility is very low. Specifically, collecting equipment (non-real estate) leases can introduce tremendous complexity. To ensure thorough collection of lease data, include a diverse group of stakeholders in meetings and project communications and examine a wide array of data sources to identify leases.

Potential sources of lease data may include, but aren’t limited to:

- Legacy real estate system
- SharePoint sites or other repositories of scanned agreements
- Fixed asset records (for existing capital leases)
- Surveys sent out to the field asking for units to identify leases under their control
- Lease footnote and disclosure work papers from previous years
- File cabinets and desks (many companies have a large portion of leases still in paper form)
- Lessor vendor software (some vendors have online tools available for tracking leases)
- P&L (locating lease expenses in the financial statements and tracing them back to the source may be the best way to identify some leases)

2. Unidentified Embedded Leases

Embedded leases are included as part of a larger agreements, and is the type of lease most often overlooked. For example, an embedded lease for alarm equipment could be part of a larger agreement with a monitoring service, or an embedded lease for servers may be included in a larger IT services contract. Overlooking embedded leases is a major risk associated with compliance, and project teams need to address the issue head-on.

Embedded Lease Examples

- Agricultural Equipment
- Alarm Equipment
- Buildings
- Communications Equipment
- Construction Equipment
- Conveyor Belts
- Easements
- Forklifts
- Janitorial Equipment
- Laptops
- Medical Equipment
- Music Equipment
- Pallet Jacks
- Real Estate
- Aircraft
- Audio Visual Equipment
- Business Equipment
- Computers
- Containers
- Copiers
- Exercise Equipment
- IT Equipment
- Land
- Manufacturing Machinery
- Medical Technology
- Office Equipment
- Rail Cars
- Restaurant Equipment
- Retail Equipment
- Right of Ways
- Scissor Lifts
- Servers
- Towers
- Transportation Equipment
- Vehicles
- Retail Racks and Shelving
- Rolling Stock
- Semi-Trucks
- Software
- Trucks
- Vessels

CoStar REAL ESTATE MANAGER™

3. Proper Separation of Lease and Non-Lease Components

Extracting the right lease components is another challenge, particularly with gross leases and embedded leases. To mitigate risk associated with extracting too much (or not enough) data associated with leases, companies should devise policies to help guide data extraction to determine what exactly constitute lease and non-lease components for compliance standards. Policies regarding the practical expedient to combine or separate components should be established early and documented well. Appropriately abstracting lease and non-lease components is critical, and contract language can quickly become complex.

Second Polling Question:

What aspect of lease accounting compliance are you most concerned with?

1. Gathering all the leases and finding all the embedded leases
2. Proper Separation of Lease and Non-Lease Components
3. Inaccurate Key Assumptions and Variables
4. Something else we haven’t discussed yet today

4. Inaccurate Key Assumptions and Variables

There are various scenarios where key assumptions are required upfront, and these assumptions can generate a substantial difference in the initial right of use asset and lease liability that will be recorded upon adoption. Examples of these key assumptions include (1) reasonably certain assumptions regarding the exercise of options, (2) establishing an incremental borrowing rate and (3) estimates for CPI or other index related increases. Auditors may ask for documentation of key assumptions, and they will also look for proof regarding the reasonability and consistent application of the assumptions.

Third Polling Question:

What is your company's current status for selecting a software system to manage data and perform ASC 842 accounting calculations?

1. We have a proven system already up and running.
2. We've identified some options and are evaluating them.
3. We're interested in finding options to review.
4. We believe our Excel spreadsheets will do fine for our needs.

CoStar REAL ESTATE MANAGER™

5. Software and Key Data Configuration Problems

Recording all leases on the balance sheet is a complex task, and other systems in use may not have the capabilities to capture the data elements required for compliance. A quality lease accounting solution like CoStar is a critical a part of an overall lease management system. Selecting a proven and well-established lease management system that includes robust lease accounting capabilities is a strategic move many companies are making now.

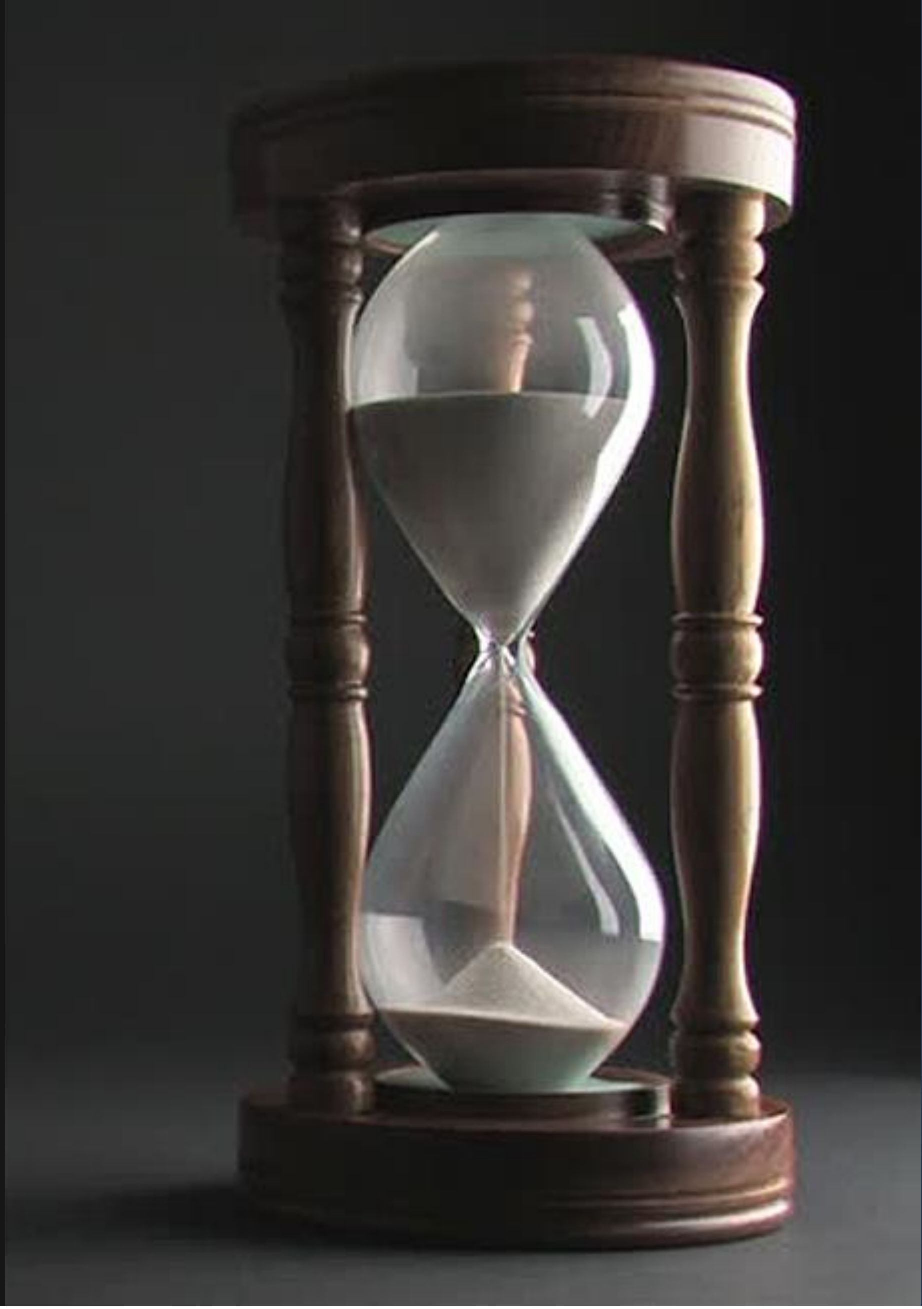
Final Polling Question:

How does your organization plan to interact with auditors for ASC 842?

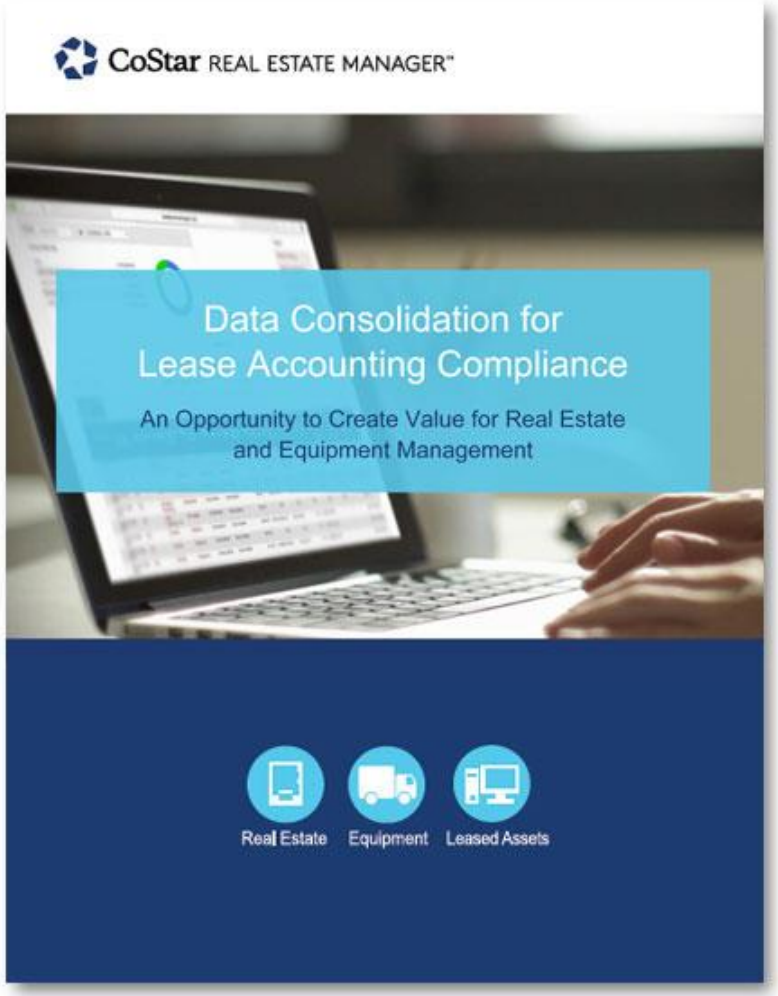
1. We've discussed our project plan and policy with our auditors already.
2. We plan to review our project plan and policy with our auditors.
3. We are getting accounting feedback from other internal or external sources and will interact with auditors during the audit.
4. We're not sure yet.

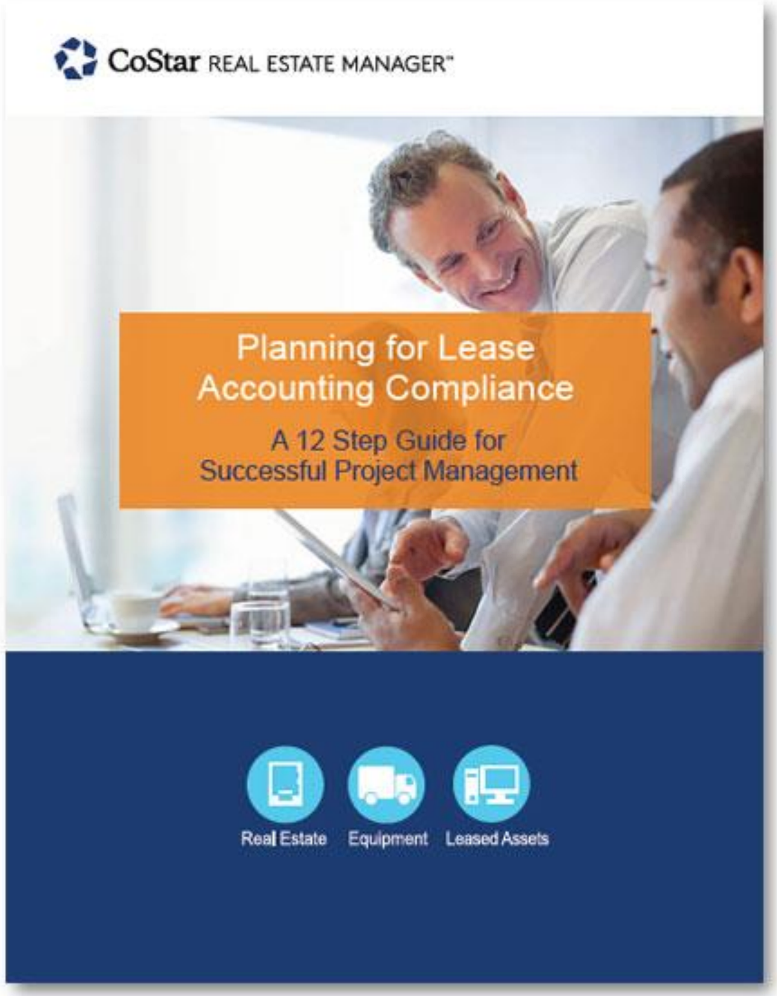
Lessons Learned from Early Adopters

Early adopters to the new ASC 842 and IFRS 16 standards consistently report that more time is needed for lease accounting compliance than originally anticipated. However, by focusing on a phased approach with an eye on these high-risk issues, companies may establish a critical path to success and ultimately make next year's audit more risk averse.



Lease Accounting Resources at costarmanager.com





2:00 – 3:00 p.m. ET

Top 5 Audit Risks for ASC 842 Lease Accounting Compliance

Questions?

Matt Waters, MBA, CPA

Lease Accounting Specialist at CoStar

Mwaters@costargroup.com

CoStar REAL ESTATE MANAGER™